UK Life Office PRA Returns Analysis

Reporting Period – Financial Year 2015

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1. Executive Summary

- In preparation for Solvency II and following the recent years of higher than normal uncertainty in the financial markets, UK Life Insurance companies are now generally in a much stronger solvency position than in previous years.
- Fixed interest securities are now more proportionally held in investment grade stock, while the equity backing ratios remains significant enough to provide optimistic prospects of growth.
- The SL ranking system now more accurately rewards companies who hold large amounts of free assets. In addition, a greater emphasis has been placed on those companies who hold proportionally larger amounts of equity investments, as these life offices should be in a position to experience greater growth.

2. What are the PRA Returns?

Each year all UK insurance companies must publish a set of prescribed returns. The content and rules behind these returns are controlled by the Prudential Regulation Authority (PRA, see next section). These aim to:

- demonstrate the company's compliance with the PRA's regulations;
- disclose the company's level of solvency; and
- display what the company "looks like" - for example, the fund's size, the company's exposure to different markets, product specifics and the basis on which the company is valued.

The PRA Returns are published in the second quarter of each year, and SL Investment Management (SL) undertakes a comprehensive review of the PRA Returns for over 30 of the top Life Offices (based upon those offices that SL deem to be most prevalent in the TEP market).

This ensures that SL continues to keep abreast of significant developments regarding with-profit funds, enabling us to assess whether there are material factors that may impact on clients' existing portfolios of TEPs and\or their current buying programmes.

3. PRA and FCA

Regulation of UK Life Insurance companies and, hence, with-profit funds is conducted by two organisations. These organisations are called the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA), each of which have separate roles for financial regulation in the UK.

The PRA was created as a part of the Bank of England by the Financial Services Act (2012) and is responsible for the prudential regulation and supervision of around 1,700 banks, building societies, credit unions, insurers and major investment firms. This includes assessing the quantity and quality of capital that a firm holds in order to meet its future liabilities, ensuring that the firm's liquidity is sufficient as well as assessing the robustness of the internal systems.

The FCA's role is to regulate conduct in the retail and wholesale markets by overseeing any trading that takes place between parties in the these markets. The FCA is able to provide greater focus on these areas than was possible with the FSA, through earlier intervention to prevent problems from developing.

4. SL's Headline Figures

SL summarises several measures from the PRA Returns - for comparison between Life Offices in which the SL advised TEP funds are heavily invested.

Free Asset Ratio (FAR)

The FAR (also known as excess working capital) is a measure of solvency on a realistic basis. It represents the realistic excess working capital (if any) available to the with-profit fund, above and beyond sums committed to be distributed to policyholders expressed as a proportion of its realistic liabilities.

A positive FAR shows that a company is holding a degree of working capital within the with-profit fund that either it does not currently intend to distribute to policyholders, or for which no strategy has yet been determined for distribution. This may indicate a potential for possible windfall payments in the future.

A zero FAR shows that the company holds sufficient capital to meet its liabilities, sufficient capital to meet its resilience tests and intends to distribute all capital in the with-profit fund to policyholders.

A negative FAR illustrates that the company intends to distribute all capital in the with-profit fund to policyholders and that adverse scenarios will be met by working capital from elsewhere (perhaps directly from the non-profit policies in the corporate body, from the non-profit fund or by way of support from a parent company).

With-Profit Benefit Reserve (WPBR)

The WPBR may be either a retrospective valuation of asset share or a prospective valuation of future bonuses; most Offices use the asset share approach to value the WPBR. In the analysis below, the WPBR is shown as a proportion of the realistic assets.

A lower percentage implies that there is a greater value of assets in excess of the WPBR to cover other future liabilities and protect against adverse experience.

Future Policy Related Liabilities (FPRL)

The FPRL covers the realistic liabilities expected by a Life Office, in addition to their WPBR. This will include items such as the cost of guarantees and smoothing[1], planned allocations from the inherited estate and obligations to treat customers fairly[2]. In Fig.1, we have reported the FPRL as a proportion of the realistic liabilities.

A high FPRL may imply that the WPBR may not be sufficient to cover contractual or non-contractual guarantees and therefore additional capital needs to be held to cover the future liabilities.

A closed Life Office may choose to distribute the inherited estate to the with-profit policyholders. If this is the case then the FPRL will include the value of any proposed transfer, this increases the liabilities and therefore restricts the free assets of the Life Office.

Proportion of Fixed & Variable Interest Securities Held in Investment Grade Assets

This figure gives an indication as to the level of security of a Life Office's fixed and variable interest investments.

A high proportion means that, of the fixed and variable interest assets held, a large number are issued from a company/government with a credit rating of at least BBB (according to Standard & Poor's).

Equity Backing Ratio (EBR)

The EBR is the proportion of assets held in equity and property and demonstrates the Life Office's attitude to risk. A high EBR implies that the Life Office is adopting a slightly riskier strategy when investing - for which they should be compensated with potentially higher returns over the long term.

WP Return

This is the reported investment return of the with-profit fund for the relevant calendar year.

Standard & Poor's (S&P) Financial Strength Rating

S&P is an independent credit rating agency. A Financial Strength Rating is designed to summarise how financially stable a Life Office is. However in some instances the rated entity is the financial group as a whole and so it is not directly applicable to the financial stability of the with-profit fund.

Surrender Value/Discounted Guarantees Less the Present Value of Total Future Premiums (SV/Disc Gtees-TFP)

This ratio is the sum of the Surrender Values (SVs), across all of SL's advised funds, divided by the sum of the guarantees (sum assured plus bonuses declared to date) less future premiums, discounted

[1] Smoothing is the process of retaining surplus profits in the strong performing years of investment, in order to enhance the payouts to investors in the years of weaker performance.

[2] Treating customers fairly may include for example, honouring the payment of guarantees and ensuring surrender values represent a fair policy value.

at 5%. Only policies with a SV quoted after the 1st January 2015 (and prior to end December 2015) have been included in the analysis.

A lower SV / (Disc Gtees-TFP) implies a policy's surrender value has a higher backing from elements that have been guaranteed by the Life Office. Such policies are more likely to be backed by a high level of fixed interest assets and their prospective returns could reflect this.

A higher SV / (Disc Gtees-TFP) implies that the surrender value of a policy is comprised of a higher proportion of non-guaranteed elements. Such policies are less likely to be backed by a high level of fixed interest assets and their prospective returns could reflect this.

Surrender Value/Estimated Asset Share (SV/EAS)

This report does not disclose SV/EAS ratios. If you would like to discuss these types of attribute further please contact us.

This ratio is the sum of the estimated SVs, across all of SL's advised funds, divided by SL's measure of EAS. Only policies held within SL's advised funds as at 31st December 2015 with a SV quoted after the 1st March 2015 have been included in the analysis.

In general, a lower SV/EAS is deemed attractive – the policy may be purchased at a good discount to EAS.

It should however be noted that the ratios provided will include a wide range of maturity dates and policy terms. As a consequence, some of the figures will be based on relatively small sample sizes. The closer that a policy is to maturity the higher the expected SV/EAS and, therefore, this statistic may not show the greater discounts available for longer dated policies.

It is therefore recommended that no decisions be made on inferences drawn from this statistic alone.

SL Rating

SL has used the information described in this report, to construct its own Life Office rating. Points have been awarded to each Life Office based upon its ranked position for six of the measures given above (a higher ranking equates to a higher score, i.e. 1st equals highest score). An average of these scores was taken across each Life Office, weighted by the measures that SL deems to be most important/informative regarding future potential growth. The ranking of these weighted average scores produces the final SL Rating; a lower SL rating represents the Life Offices for which we would envisage there is a greater prospect of future potential growth.

The process described above is performed on over 30 of the Life Offices that are considered to be the most prevalent in the TEP market and the table below shows the top 20. General Accident tops the list for the 2015 reporting year, as a result of a very strong showing across all of the categories that feed into the rating, in particular it's FAR and EBR. Royal London and Commercial Union also rank highly, largely due to their increased amount of free assets and EBR respectively. Thes features should ensure that they are in a position to take full advantage of any future growth in the equity market as well as being in a strong financial position with the possibility of distributing the surplus to the policyholders.

The top five positions are occupied by the same five funds as in the analysis for the 2014 reporting period. However, Teachers Assurance have dropped from the top of the list in the preceding years' analysis, due almost entirely to the reported figure of zero free assets (when it was over 60% previously).

Life Office	FAR [1]	WPBR [2]	FPRL [3]	% of FI & VI Securities Held at Investment Grade [4]	EBR [5]	2015 Return [6]	S&P Rating [7]	SV/(Disc Gtees-TFP) [8]	SL Rating [10]
General Accident Life Assurance	11.5%	73.2%	4.3%	88.0%	53.0%	6.1%	A+	119.8%	1
Royal London Mutual Insurance Society	44.1%	51.6%	6.8%	88.6%	44.3%	4.2%	A	130.1%	2
Commercial Union Life Assurance Company	11.5%	73.2%	4.3%	88.0%	53.0%	6.1%	A+	126.9%	3
Teachers Assurance Company	0.0%	48.4%	49.5%	98.0%	57.6%	2.3%	n/a	120.3%	4
National Farmers Union Mutual Insurance Society	24.6%	62.3%	17.9%	94.2%	54.1%	3.6%	n/a	183.5%	5
Scottish Amicable Life Assurance Society	0.0%	78.7%	15.0%	77.9%	51.4%	3.2%	AA	134.9%	6
Legal & General Assurance Society	5.1%	82.9%	8.6%	83.1%	40.2%	3.1%	AA-	125.5%	7
Liverpool Victoria Friendly Society	11.0%	63.9%	12.1%	96.4%	35.8%	2.7%	BBB+	144.1%	8
Wesleyan Assurance Society	20.2%	78.8%	0.0%	90.3%	66.3%	2.0%	n/a	137.6%	9
Royal Liver Friendly Society	0.0%	67.5%	27.3%	96.2%	33.4%	5.1%	A	106.7%	10
Clerical Medical & General Life Assurance Society	0.0%	70.6%	20.1%	80.1%	38.9%	2.3%	A	128.8%	11
Scottish Widows Fund & Life Assurance Society	0.7%	67.4%	20.8%	78.7%	47.8%	2.8%	A	135.4%	12
United Friendly Life Assurance	0.0%	88.9%	10.2%	93.3%	35.9%	3.5%	A	141.1%	13
National Mutual Life Association of Australasia	0.0%	37.3%	50.5%	100.0%	38.7%	2.3%	A+	168.5%	14
Prudential Assurance Company	8.8%	79.9%	5.1%	72.1%	45.5%	3.6%	AA	132.6%	15
Friends Provident Life Office	0.0%	74.4%	19.3%	99.4%	33.3%	2.5%	A+	133.8%	16
Guardian Assurance Company	0.0%	67.6%	28.2%	98.6%	45.2%	1.0%	n/a	170.6%	17
Norwich Union Life Insurance Society	8.8%	65.1%	19.1%	82.8%	38.0%	5.4%	A+	138.9%	18
Standard Life Assurance Company	0.0%	68.2%	12.3%	96.1%	32.2%	2.6%	A+	125.1%	19
Co-operative Insurance Society	0.0%	55.1%	22.1%	74.3%	27.6%	4.4%	A	134.4%	20

1 Source: 2015 FSA returns Form 19
2 Source: 2015 FSA returns Form 19
3 Source: 2015 FSA returns Form 19
4 Source: 2015 FSA returns Form 49
5 Source: 2015 FSA returns Form 48
6 Source: 2015 FSA returns Form 48
7 Source: S&P w ebsite (as at 31/07/2016)
8 Source: SL Database
9 Source: SL Database
10 Source: SL Based Rating System

5. Appendix A

Below is the table from the most recently released report from 2015, based on the 2014 financial reporting year.

Life Office	FAR [1]	WPBR [2]	FPRL [3]	% of FI & VI Securities Held at Investment Grade [4]	EBR [5]	2014 Return [6]	S&P Rating [7]	SV/(Disc Gtees-TFP) [8]	SL Rating [9]
Teachers Assurance Company	63.4%	50.5%	12.2%	99.8%	56.8%	7.2%	n/a	111.3%	1
National Farmers Union Mutual Insurance Society	23.8%	60.7%	20.1%	95.0%	54.0%	9.9%	n/a	151.6%	2
Royal London Mutual Insurance Society	42.7%	53.1%	8.2%	90.5%	44.4%	10.7%	A	111.7%	3
General Accident Life Assurance	11.1%	71.6%	4.4%	82.8%	45.2%	8.1%	A+	110.3%	4
Commercial Union Life Assurance Company	11.1%	71.6%	4.4%	82.8%	45.2%	8.1%	A+	120.5%	5
Scottish Widows Fund & Life Assurance Society	0.8%	67.5%	20.0%	93.6%	50.4%	7.0%	A	131.9%	6
Legal & General Assurance Society	2.8%	82.9%	8.5%	85.9%	42.4%	9.8%	AA-	129.5%	7
Wesleyan Assurance Society	21.7%	75.0%	2.9%	93.1%	65.4%	6.3%	n/a	142.0%	8
Prudential Assurance Company	8.6%	80.5%	5.2%	69.8%	41.0%	8.3%	AA	134.3%	9
Friends Provident Life Office	0.2%	72.1%	17.7%	99.4%	30.9%	7.3%	A	129.6%	10
Guardian Assurance Company	0.0%	68.4%	27.4%	97.3%	45.6%	5.5%	n/a	183.6%	11
Norwich Union Life Insurance Society	8.2%	65.5%	16.6%	78.1%	35.0%	9.1%	A+	120.5%	12
Clerical Medical & General Life Assurance Society	0.0%	73.5%	21.0%	89.9%	39.2%	7.1%	A	125.4%	13
National Mutual Life Association of Australasia	0.0%	39.5%	50.3%	100.0%	38.2%	7.3%	A	159.0%	14
Royal Liver Friendly Society	0.0%	69.0%	26.3%	95.6%	32.5%	12.3%	A	107.9%	15
Standard Life Assurance Company	0.0%	68.7%	11.4%	96.1%	34.9%	8.6%	A+	121.4%	16
United Friendly Life Assurance	0.0%	89.4%	9.6%	93.6%	35.8%	16.6%	A	138.0%	17
Liverpool Victoria Friendly Society	7.7%	61.3%	16.0%	89.5%	34.6%	11.9%	BBB+	145.2%	18
Britannic Assurance	0.0%	89.0%	10.3%	92.7%	37.1%	9.7%	n/a	139.9%	19
Scottish Equitable Life Assurance Society	0.0%	62.2%	29.0%	97.7%	27.5%	5.8%	A+	128.5%	20

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3 Source: 2014 FSA returns Form 19
4 Source: 2014 FSA returns Form 49
5 Source: 2014 FSA returns Form 48
6 Source: 2014 FSA returns Form 48
7 Source: S&P website (as at 31/08/2015)
8 Source: SL Database
9 Source: SL Based Rating System

It should be noted SV/EAS figures are allowed for in the ratings but not shown in the table due to the proprietary nature of the calculations

Fig.1

Disclaimer

This report and its content are intended solely for professional advisors or institutional investors. It must not be used or relied upon by private or retail investors.

The information in this document has been compiled from the reports to the PRA issued by the stated life assurance companies during 2016 in respect of the 2015 Financial Year. Its intended purpose is to summarise some of the key facts and figures from those reports pertinent to with-profits endowments issued by those companies.

Where the process of compiling this document has involved subjective judgement or approximation we have followed an approach that we consider suitable for this purpose. While we hope you will find the information helpful, it is provided on the basis that we do not give any representation or warranty that the information is complete and accurate, that it has been correctly extracted or that it is suitable to be used for purposes other than that for which it was originally intended. Nothing in this document should be considered to constitute financial or other professional advice or recommendations.

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